



TCX creates first frontier currency bond index

The Currency Exchange Fund (TCX) has created the first frontier currency bond index, the TCX FI. The index, launched on March 25, tracks the performance of frontier currency-linked investment-grade Eurobonds issued by development finance institutions, a growing segment of the MTN market.

The index currently covers 77 notes in 20 frontier currencies where TCX acted as a hedging counterparty to SSA issuers.

The frontier currency market suffered from not having an instrument that could track the performance of bonds issued in these currencies, Lucero Cabrera, Vice President at TCX responsible for index structuring told mtn-i.

“Why was there not already an index for frontier local currency bonds? Our conclusion after talking to data providers was that simply there were not enough assets widely available to investors, not enough price information, nor enough investor demand to justify developing an index from a commercial standpoint,” said Cabrera. “Ironically, potential investors said that they would be more interested in frontier assets if more price information was available.”

TCX, acting as a hedging provider for frontier currency MTNs, was in an ideal position to develop a benchmark indicator that allows to track the performance of these notes. “Liquidity and the secondary market for the bonds is still very limited, and we believe that price transparency will help the market to develop,” noted Cabrera.

The fund performed a back-testing of the index which showed that the frontier currencies portfolio outperformed a similar emerging market currencies portfolio in risk/return and in diversification terms.

“We look to raise awareness among investors around what assets are available, and ultimately, support the development of a market for them”, said the index structurer.

GRAPHIC: TCX FI Performance: 2018 - March 25, 2021



Source: TCX

Increased transparency

Cabrera said that the rationale behind the index was “to increase awareness concerning available frontier assets, to contribute to price transparency of these assets, and support the sustainable development of local capital markets.”

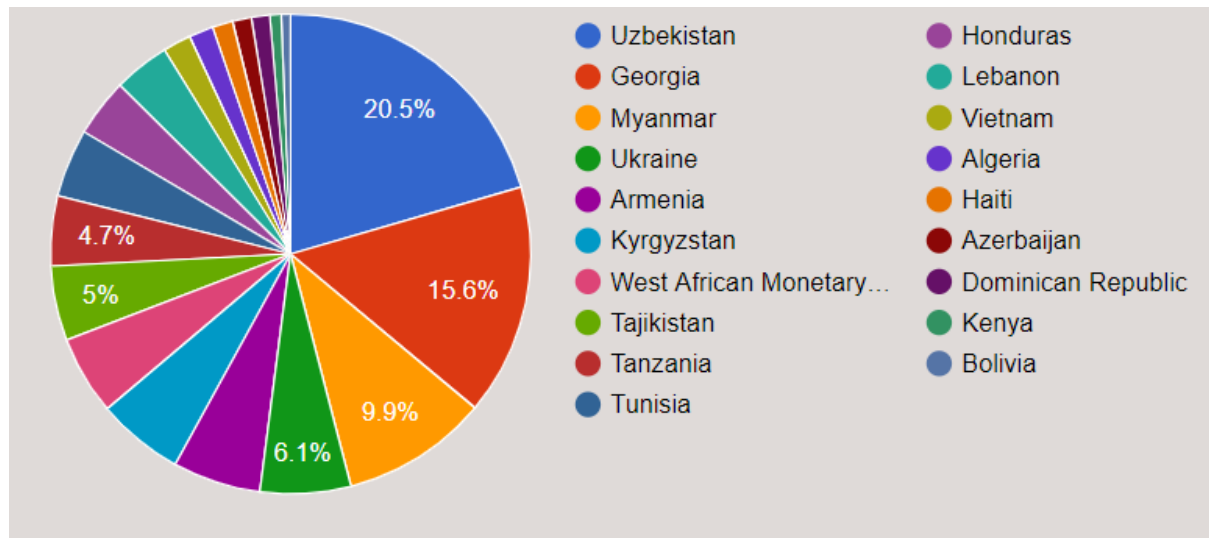
She pointed out that the regional effort led by the African Development Bank, the African Domestic Bond Fund and the AfDB/AFMISM Bloomberg African Bond Index is “a good example of how investors’ awareness increases when price information is available.” The Africa-focused bond index, which was launched in 2015 to include Egypt, Kenya, Nigeria and South Africa, **from this year** also includes Botswana, Namibia, Ghana, Zambia, Mauritius and Morocco.

One notable deal from earlier this year, in which both the TCX and the **AfDB** are involved, is a USD6m 7.9% 1-year synthetic trade linked to Kenyan shilling, which is a currency part of the TCX FI. This is the only identified offshore note from an SSA linked to the African currency this year, according to mtn-i data.

The criteria for selecting the instruments and currencies in the index was primarily to reflect what is available in the market, and secondly, to be present in those currencies where markets are thin or non-existent. “With

that in mind, we chose to include currencies that are not covered by two or more of the major emerging market indices,” added Cabrera.

GRAPHIC: TCX FI Currency Distribution: As of March 25



Source: TCX

Frontier market impact

TCX chose frontier currency denominated or linked offshore notes for their “unique characteristics,” remarked Cabrera. By settling in US dollars or Euros, the structure of these notes eliminates convertibility and transfer risk for investors.

The deals issued by high-grade SSAs offer high yields, with an average coupon of 10%. They also provide rare currency exposure that comes with the high credit ratings of these issuers. Being issued offshore, investors have access to convenient market infrastructures and the legal certainty of international listings, added Cabrera. Finally, frontier market countries represent around 10% of the world’s GDP and 30% of the population.

Buying frontier currency debt is not for every investor due to limited liquidity, regional concentration, and smaller deal sizes, said Cabrera, echoing MTN dealers. Bankers active in the market say that demand for frontier currencies has been growing since the second half of last year.

The added price transparency from the new index should foster increased supply and demand. “Bringing transparency to the data improves the whole ecosystem,” the structurer told mtn-i. “The index could trigger the surge of

exciting new investment, financing, and hedging solutions that support the sustainable development of frontier local markets.”

The German Federal Ministry for Economic Cooperation and Development made it possible to create the index, said TCX.